EPG

CAPACITY-BASED PLAN FOR INTERCARRIER COMPENSATION

July 22, 2004

THE EPG GROUP

- Started by small and mid-size rural LECs and industry consultants
- Dedicated to preserving three viable and sustainable revenue streams – currently, access, local and USF
- Recognizes the evolution from a circuit-switched to a packet-switched network environment
- Phased implementation based upon market and technology drivers
- Actively seeking input to make the plan responsive to the needs of multiple stakeholders

INTERCARRIER COMPENSATION ISSUES

- Disparate charging mechanisms based on:
  - Jurisdiction (intrastate, interstate)
  - Nature of the call/technology (local, long distance, Internet)
  - Type of carrier (LEC, IXC, CMRS, ISP, end-user)
- System is neither economically rational nor sustainable
  - Disparities leading to arbitrage and/or fraud
  - Phantom traffic
  - Inability to differentiate between interstate, intrastate and local traffic

INTERCARRIER COMPENSATION ISSUES

- Fundamental nature of the network is changing.
  - Current compensation mechanisms are premised on an analog, circuit-switched network.
  - Rapid evolution towards a digital, packet-switched network.
  - VoIP is coming on fast!
  - Intercarrier compensation must likewise evolve if rural consumers are not to be left behind

VIABLE "THIRD REVENUE STREAM" NEEDED FOR RURAL AMERICA

- Rural networks are more costly to build due to longer distances and lower traffic volumes.
- On average, rural carriers receive over 25% of their cost recovery from intercarrier compensation; many recover over 50%.
- Those who invest to build rural networks must receive fair compensation for use of their property.

VIABLE "THIRD REVENUE STREAM" NEEDED FOR RURAL AMERICA

- Bill and Keep would place unnecessary strain on currently overburdened USF mechanisms and/or rural consumers.

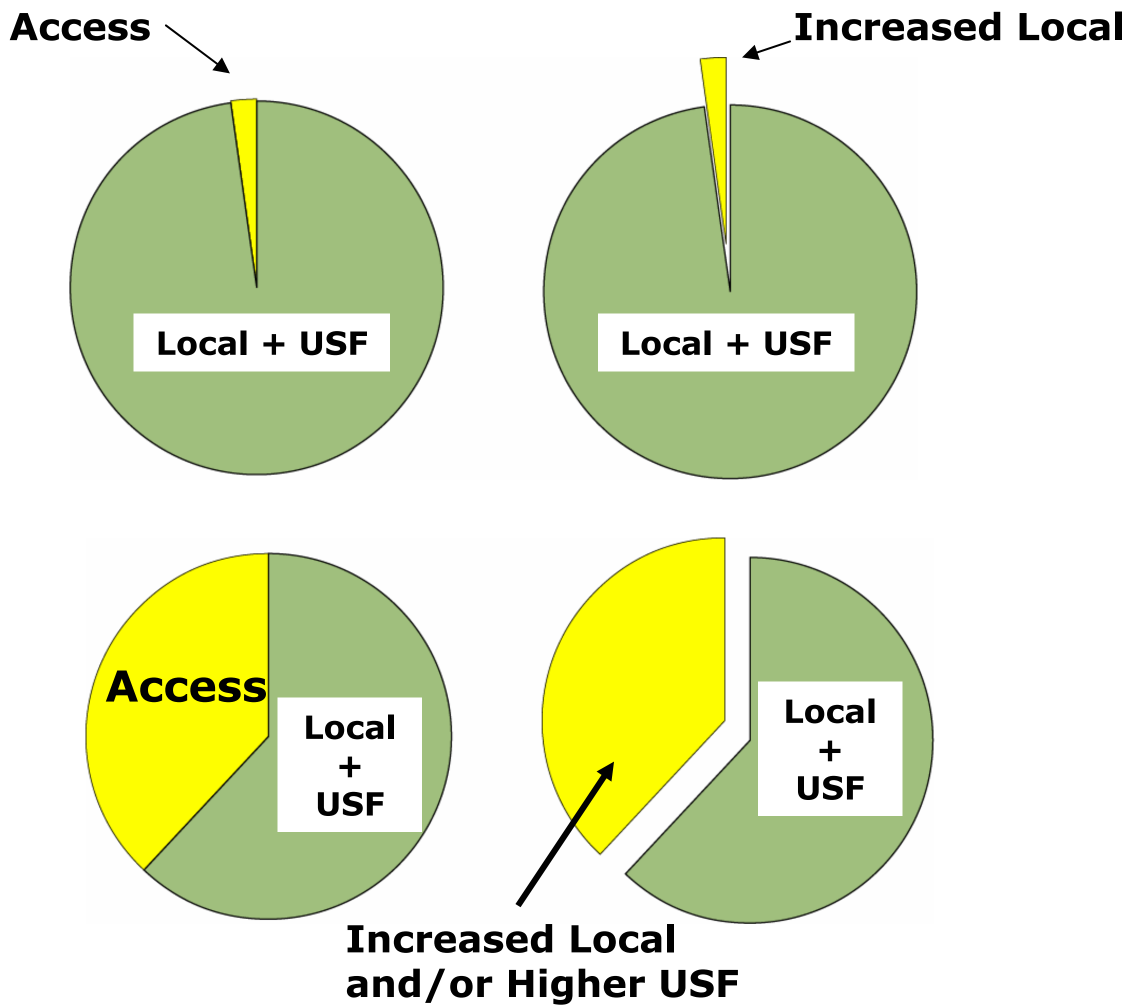
- A unified intercarrier charging mechanism does not mean a price of zero.
  - Zero price for network usage sends false pricing signals resulting in inefficient network usage.
  - Rural carriers would lack the resources and incentives to invest to carry growing traffic loads and to deliver broadband services.

LEC REVENUES

CURRENT **BILL AND KEEP**

LARGE LECS WITH LOW COSTS

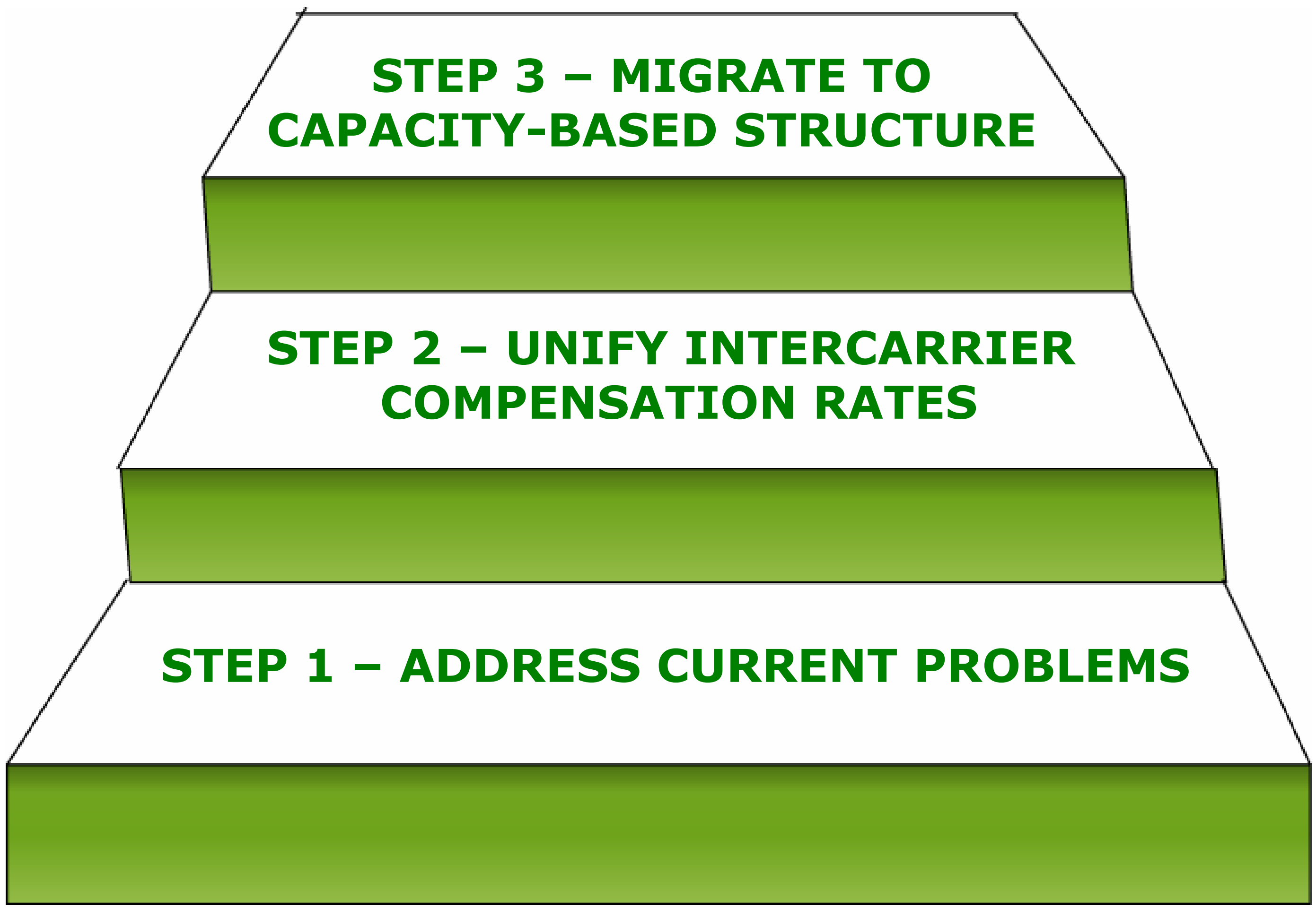
RURAL LECS WITH HIGH COSTS



KEY CONCEPTS OF THE EPG PLAN

- Bill and Keep will not serve the interests of rural consumers. It will stifle network investment.
- Current intercarrier compensation mechanisms should converge.
  - Address anomalies in current compensation mechanisms
  - Generally reduce intrastate switched and special access to interstate levels and structure
  - Move toward a capacity-based structure, including Ports and Links, to be consistent with the evolution toward packet-based networks
- A bulk-billed Access Restructure Charge (ARC) should replace lost revenues.
  - Available only to regulated providers of access
  - Funded through an assessment on all working telephone numbers

EPG CAPACITY-BASED PLAN



STEP 1 - ADDRESS CURRENT PROBLEMS

- "Truth in Message Labeling" national policy articulated
  - Addresses issue of phantom traffic
- Clarify ESP Exemption to be dial-up only (i.e., not terminating)
  - Consistent with goals of original ESP Exemption
  - Avoids large-scale VoIP bypass of charges for use of PSTN
- Default termination tariffs adopted
  - Eliminate CMRS bypass of reciprocal compensation obligations

STEP 2 - UNIFY INTERCARRIER COMPENSATION RATES

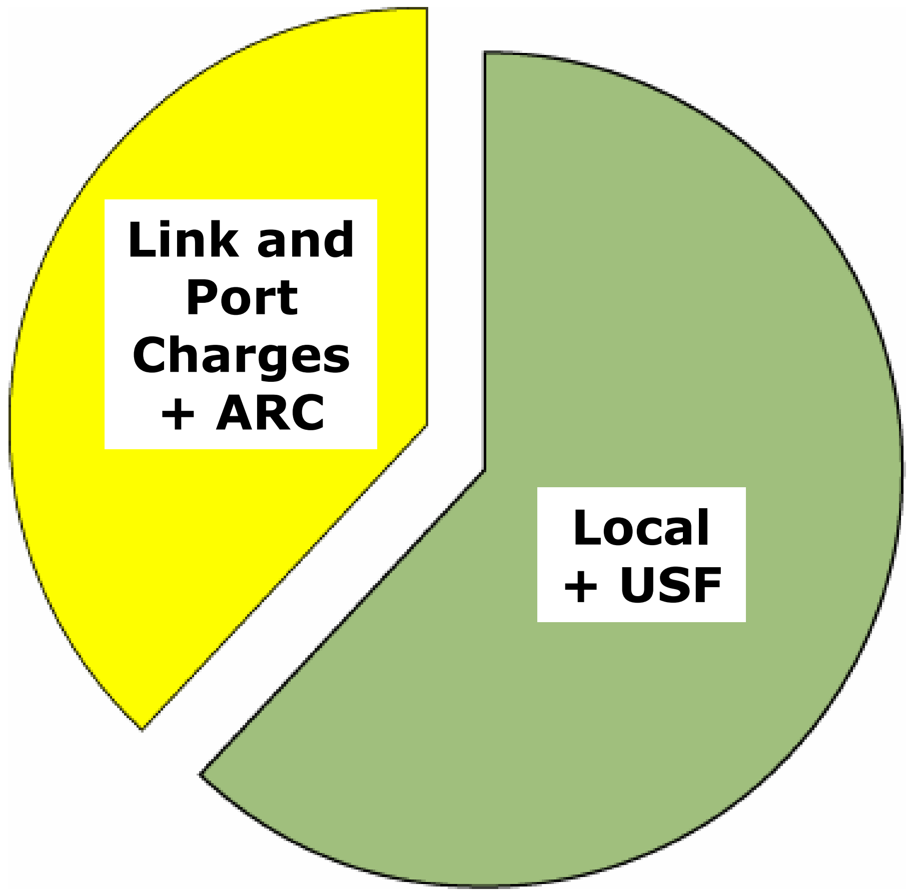
- Reduce intrastate switched, special access and reciprocal compensation to current interstate levels and structure.
  - Does not require development of new cost standard

- Introduce Access Restructure Charge (ARC) to replace lost rural LEC revenue.
  - Preserves intercarrier revenue contribution to cost recovery and universal service goals
  - Use State Restructure Credit (SRC) to preserve equity among states.
  - Collected based on assessment on working telephone numbers

STEP 3 - MIGRATE TO CAPACITY-BASED STRUCTURE

- Up to two years following convergence of intercarrier mechanisms
- Migrate switched access to Ports and Links structure consistent with cost drivers of a packet-switched network.
- Evaluate additional Quality of Service rate elements consistent with a packet-based network architecture.
- ARC maintains intercarrier revenue contribution.

RESULT OF CAPACITY-BASED PLAN



KEY ELEMENTS OF AN ICC SOLUTION

- A viable third revenue stream is essential.
  - Universal service goals will be easier to achieve if intercarrier revenues are preserved.
- A common ICC charging mechanism must be implemented that:
  - Avoids incentives and opportunity for arbitrage
  - Is computed in a manner that avoids further revenue erosion
  - Allows carriers to maintain a viable third revenue stream
- ICC mechanisms must evolve with markets and technology.
  - As packet-switching and VoIP evolve, rural LECs must be ready.
  - All carriers may not need to migrate at the same pace.
  - Markets and technology will be the drivers.

ADVANTAGES OF EPG PLAN

- Maintains balanced revenue flows among end user, intercarrier compensation and USF
- Promotes broadband deployment for rural consumers
- Requires no separations or legislative changes
- Requires no development of new costing methodologies
- Requires no increase in SLC caps
- Minimizes impact on current USF mechanisms
- Seeks appropriate balance between state and federal regulation
- Can be applied to all providers of access

More information:

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